HELP ?

Bretton Woods--original intentions and current problems

Contemporary Economic Policy; Huntington Beach; Oct 2000; Raymond F Mikesell;

Sic: **522298** *Sic:* **522298**
Volume: 18
Issue: 4
Start Page: 404-414
ISSN: 10743529
Subject Terms: Studies
Economic policy
International
Classification Codes: **9180**: *International*
9130: *Experimental/theoretical*
1120: *Economic policy & planning*
Companies: International Monetary Fund *Sic:* **522298**
IMF *Sic:* **522298**

Abstract:
The Bretton Woods institutions have been subjected to a variety of criticisms in recent years and have been faced with severe problems in carrying out their objectives. The International Monetary Fund (IMF) and the World Bank have not performed in accordance with the original intentions of their founders. As shown in this article, this is in large measure because the world economic environment has been quite different from that envisaged by the participants in the Bretton Woods conference. Many of the original intended functions for these institutions are no longer relevant. This article examines the current problems facing the IMF and World Bank, with special attention to how they are rei they are related to the original intentions. For example, in recent years, a major problem has been the financial crises of member countries that have liberalized their economies in line with trends toward globalization.

Full Text:

[Headnote]
The Bretton Woods institutions have been subjected to a variety of criticisms in recent years and have been faced with severe problems in carrying out their objectives. The International Monetary Fund (IMF) and the World Bank have not performed in accordance with the original intentions of their founders. As shown in this article, this is in large measure because the world economic environment has been quite different from that envisaged by the participants in the Bretton Woods conference. Many of the original intended functions for these institutions are no longer relevant. This article examines the current problems facing the IMF and World Bank, with special attention to how they are related to the original intentions. For example, in recent years, a major problem has been the financial crises of member countries that have liberalized their economies in line with trends toward globalization. These crises have resulted in demands on the IMF and World Bank for financial assistance for purposes other than those for which their assistance was originally designed. Other problems of the two institutions include providing assistance to the world's poorest countries that have made virtually no development progress in recent years, and assisting the former communist countries in transition to market economies. The author gives his personal views on how these and other problems of the IMF and World Bank should be dealt with: (JEL F31, F33)

[Headnote]
ABBREVIATIONS

[Headnote]
ICU: International Clearing Union
IFC: International Finance Corporation
IMF: International Monetary Fund
SDR: Special Drawing Rights

I. INTRODUCTION

The policies and functions of the Bretton Woods institutions-the International Monetary Fund (IMF) and the World Bankhave in recent decades differed substantially from the intentions of the participants in the Bretton Woods conference of July 1944. The IMF was an agreement to stabilize currencies and avoid restrictive exchange practices. It provided short-term liquidity to members with current account deficits, conditioned on their taking measures to restore balance of payments equilibrium. The World Bank was intended to make loans and guarantees for post-World War II reconstruction and for economic development. Although there was agreement at Bretton Woods on these general functions, there was disagreement on a number of issues, particularly those relating to policies and activities of the IMF The intentions of the conference participants were not fully or clearly reflected in the Articles of Agreements or charters of the two institutions drafted at the 1944 conference. The provisions of the IMF charter were a compromise between U.S. and British positions set forth in an agreement negotiated prior to Bretton Woods. Some of the provisions of the IMF charter were interpreted differently by the representatives of the two countries, and there was far from full agreement among the delegates of the forty-four countries participating in the conference on the text of the IMF charter (Mikesell, 1994).

The conference was dominated by the Americans and British, and although many alternative provisions of the charters were debated, the basic provisions that had been agreed to by the Americans and British prior to the conference were adopted by unanimous vote. For these reasons, the intentions of the participants regarding some of the important policies of the two institutions were far from uniform. However, changes in the world economy over the past half century have made many of the differences in intentions irrelevant. For example, the World Bank was intended to play a major role in postwar reconstruction, but this function was taken over by the Marshall Plan. Likewise, the role of the IMF for promoting convertibility of the currencies of the major countries was supplanted by the European Payments Union under the management of the Bank for International Settlements, which resulted in the interconvertibility of European currencies but not their convertibility into dollars. As a consequence, the IMF and World Bank made few loans to developed countries, and both institutions mainly provide financial assistance and advice to developing countries.

The IMF, which was intended to play an important role overseeing the world's payments system, has had little influence following the abandonment of the par value system. This occurred ironically because the U.S. government, which was the major champion of an agreement on exchange rate stability, went off the gold standard in 1971, thereby eliminating the international currency standard on which the IMF's par value system was based.

The major difference between the American and British positions on the functions of the IMF-positions that were somewhat ambiguous in the text of the IMF charter-had to do with administration of the IMF's financial assistance. John Maynard Keynes wanted the IMF's largess to be administered by a secretariat largely independent of the member country-appointed executive directors, who he believed should meet only occasionally to decide on major policy matters. Harry White, upon whose original concept the IMF's charter was based, wanted the executive directors to be fully involved in lending and other activities. He also wanted the IMF to set forth detailed conditions for the use of its resources. In contrast, Keynes wanted few conditions on lending and argued that each member should be allowed to draw a minimum amount from the IMF freely, so that it could regard this amount as equivalent to its own reserves. White's position prevailed in the actual operation of the IMF Not only do the executive directors meet in continuous session and work closely with IMF's management, but the conditions for obtaining loans have become more comprehensive regarding the policies to which member countries must agree-more than even White would have anticipated. A major reason for the latter is that in making loans to developing countries the IMF has sought to impose conditions to promote sound development. The loan conditions now required by both the IMF and the World Bank include institutional changes, such as privatization of state-owned industries and reform of the legal system, including property rights and conditions governing foreign investment. Keynes also wanted to give the members more freedom to change their par values than did White, who was concerned that there would be competitive exchange depreciation in the postwar period, similar to what existed in the 1930s. Actually, there was almost no tendency for countries to depreciate their currencies as a means of improving their competitive position in world markets. The major problem for the IMF with respect to exchange rates was to induce countries to depreciate when their currencies became overvalued.

Keynes recommended important changes in the World Bank charter from the draft submitted by the U.S. delegation. He wanted the World Bank to borrow from the market rather than use members' subscriptions for making loans. Keynes's recommendations were largely accepted by White and others. However, Keynes wanted the World Bank to have authority to make general-purpose loans rather than making loans solely for specific projects, such as railroads or dams, as White had proposed. Although the language in the charter provided that the World Bank should use its funds primarily to finance specific projects, in recent years a large proportion of its loans have been to finance broad programs rather than specific projects. This has been the result of the increasing involvement of the World Bank with economic and social development.

Both White and Keynes believed that the IMF's assistance to members should not finance capital flight. However, the IMF has not maintained this position. The IMF's loans in response to the financial crises in the East Asian countries during the 1990s were primarily for the purpose of helping members restore confidence in their securities markets and currencies, rather than for financing imports. Moreover, according to a recent statement by Secretary of the Treasury Lawrence E. Summers, emergency loans to countries facing currency crises should be the principal lending function of the IMF (Kahn 1999.

To a considerable degree the changes in the policies and activities of the IMF and World Bank from those originally intended have been largely due to changes in the world financial environment that were not anticipated in 1944. The charters have not constrained their managers from doing what they wanted to do in response to the emerging world environment. In some cases, they have interpreted the charters quite liberally. In other cases, they proposed amendments to the charter or requested the formation of subsidiaries, such as the International Finance Corporation (IFC) or the Special Drawing Rights (SDR), program which increased the volume of international reserves. The governments of the leading member countries have been quite cooperative in giving managers what they wanted, mainly because the policies of the IMF and World Bank fit very well with the national policies of these members. They provide a means of giving aid to developing countries that does not appear on the national budgets of the donors. Most of the World Bank's loan funds come from borrowing in the international financial markets, while subscriptions to the IMF are not paid as national budget expenditures but are made in the form of promissory notes. Moreover, when dollars are drawn from the IMF by borrowing countries, the country whose currency is used receives an equivalent amount of international monetary reserves in the form of drawing rights in the IMR

Despite the flexibility of the institutions for dealing with new conditions, they have not been as successful in solving the world's major financial problems as their founders had hoped and promised to the public and their governments. This has led many economists and public officials to call for changes in their structure and policies and, in some cases, for their abandonment. It is quite possible that some of these problems are greater and more complex than can be dealt with by any international financial institutions. The real issue may be how these institutions can be altered to make a greater contribution to the solution of current financial problems.

It. PROBLEMS FACING THE IMF AND WORLD BANK

Of the many problems that face the IMF and World Bank, I have selected the following for discussion, all of which relate in some way to the original intentions of the founders:

1. How to advise and assist developing countries experiencing financial crises. This has been mainly a problem for the IMR

2. How to advise and assist countries in transition from communism to market economies. This has been a problem for both the IMF and World Bank.

3. How to promote economic and social development in countries lacking the basic institutions for sustained growth, including (a) a legal system that protects personal and property rights; (b) free markets for commodities and capital; and (c) an efficient and uncorrupted public administration for taxation, education, and other social services that would enable the majority of the population to move out of poverty and low productivity. The IMF and the World Bank need to coordinate their advice and assistance for promoting these objectives.

4. What to do with the SDR program, established in 1969 and administered by the IMF

5. How to deal with the existence of two institutions making the same kinds of loans to the same countries. This problem has led some to suggest that the operations of the two institutions be fully coordinated, whereas others believe that the IMF should be eliminated or merged with the World Bank.

1.

Financial Crises in Developing Countries

Financial crises in some of the more advanced developing countries have occurred following their participation in globalization. Globalization in the fullest sense means a merging of domestic markets with world markets for commodities, currencies, and financial capital. Participating in globalization provides important advantages, such as larger capital imports often accompanied by technology and greater access to international commodity markets. However, globalization, as contrasted with government controls over trade, foreign exchange, and capital movements, has the disadvantage of making countries more vulnerable to economic shocks. The financial crises that occurred in Mexico in 1995; in Indonesia, South Korea, and Thailand in 1997-98; and in Brazil in 1998 were accompanied by requests for loans from the IMF, World Bank, and other sources of financial assistance. The origin of these shocks has been a combination of adverse internal developments, such as bank failures and capital flight, which have brought pressure on exchange rates. There has been a tendency for political leaders in some of the countries in crisis to put the blame on foreigners. For example, the prime minister of Malaysia made the ridiculous statement that Malaysia's 1997 financial crisis was due to a conspiracy of foreign investors who wanted to harm a Muslim country! Actually, recent studies have found that the root causes of the financial crises were largely internal (Kregel, 1998).

Banks in developing countries have been shown to be especially vulnerable to default on foreign loans following financial liberalization. In a statistical analysis of 76 currency crises and 26 banking crises in 20 developing countries over the period 1970-1995, Kaminsky and Reinhart (1999) found a high correlation between the two crises following market liberalization. The obvious lesson from this analysis is that there should be stronger banking regulations and supervision. It also suggests the desirability of some limitation on foreign borrowing by banks, especially short-term borrowing for making long-term loans on real estate and other nonliquid investments.

The financial crises of the 1990s were characterized by sharp declines in the securities markets, defaults on foreign and domestic loans, and substantial currency depreciation, followed by recessions (Moreno, 1999). These financial crises differ from the traditional balance of payments disequilibria for which the

IMF has provided financial assistance. The traditional balance of payments problem was a current account deficit, usually created by a sudden decline in exports or by macroeconomic policies that resulted in inflation and a surge in demand for imports. This was the balance of payments problem envisaged at Bretton Woods for which members would seek assistance from the IMR The purpose of the assistance was to maintain imports of goods and services so that the country would not need to impose import controls, undergo a depression, or devalue its currency while taking steps to restore equilibrium. The IMF usually required borrowers to apply restrictive monetary and fiscal measures for reducing their deficits.

But neither a sharp drop in exports nor inflation has played a significant role in recent financial crises in countries that have globalized their markets. Governments have sought assistance from the IMF mainly to enable them to maintain the exchange value of their currencies in the face of capital flight and to service external debts. The conditions imposed by the IMF on these members have taken the form of restrictive macroeconomic policies. Thus, the traditional conditions for obtaining IMF assistance have been maintained, but the financial crises that led to the requests for assistance have been quite different. The restrictive macroeconomic policies required by the IMF have resulted in high interest rates and a reduction in consumer purchasing power and business credit, which in turn have caused recession, low investment, and unemployment. **Jeffrey Sachs** (1997) has charged the IMF with prescribing the "wrong medicine" to the East Asian countries.

The IMF responded to severe crises in three East Asian countries in 1997 and in Brazil in 1998. The credits made available by the IMF and other external sources to these countries were very large (over $40 billion to both South Korea and Indonesia), subject to performance under specified conditions that included monetary and fiscal restrictions. The credits were used mainly to support the currency and to meet obligations on external debts. It was expected that this financial assistance would restore confidence in both the capital and foreign exchange markets and that restrictive monetary policies would attract foreign capital by increasing interest rates. The strategy did not work. Capital flows were not reversed. Indonesia's currency declined initially by 80%, (by 50% in Thailand, South Korea, and Brazil) while interest rates soared. The sharp fall in currency values raised prices of essential consumer goods, and the rise in interest rates generated recession and unemployment. Monetary and fiscal policy should have been used to sustain demand, which had been reduced by bank failures and the decline in capital imports. Though there was evidence of overvaluation of exchange rates in some of the countries in financial crisis, a currency free-fall should have been avoided.

How would the Bretton Woods founders have regarded the use of IMF credits for maintaining exchange rates and meeting foreign debt obligations? Assistance from the IMF used primarily for financing capital flight appears to be a violation of Article VI of the Fund Agreement, which states that "a member may not make net use of the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund" (IMF, 1969, vol. 1, 185-214). The IMF's resources were to be used to finance temporary current account deficits while actions were being taken to restore equilibrium. Members receiving financial assistance were required to use capital controls to avoid capital flight. Keynes believed that all countries, including the United States, should maintain controls on capital movements, but White looked forward to a time when all capital markets would be free of restrictions.

There have been debates in the IMF on the application of Article VI in the past, but as far as I am aware, no member has been denied financial assistance during a financial crisis on the grounds that the principal use of the credits was for maintaining the exchange value of the currency or servicing foreign debt. One of the first cases in which a member country experiencing a financial crisis received assistance from the IMF was in 1956 when the United Kingdom's capital market was disturbed by the Suez crisis. There was no significant increase in Britain's current account deficit at the time, so the assistance was used to support the exchange value of sterling.

The World Bank has also been providing assistance to the East Asian countries experiencing crises, even though these countries have relatively high per-capita incomes. Rather than supporting currencies and debt repayment, the World Bank has emphasized development aid, particularly that supporting social development. Joseph Stiglitz, the World Bank's chief economist, implied criticism of the IMF for not paying more attention to maintaining production and investment in the countries to which it has provided credits (Uchitelle, 1999). A recent report published by the World Bank (199899) describes how social development is being adversely affected by the recent financial crises and how the crises are especially hard on the poor. A similar analysis appeared in a recent article in an Inter-American Development Bank publication (Lustig, 1999). The World Bank report suggested the following "priority actions" to protect the poor during financial crises:

1. Generating income for the poor through direct cash transfers and public works.

2. Preserving the human capital of the poor by maintaining basic health and nutrition services.

3. Ensuring food supplies through direct transfers and price stabilization of essential commodities.

4. Providing training opportunities, job search, and other assistance to the unemloyed.

These protective actions are not found in IMF loan conditions and, indeed, may be incompatible with the harsh macroeconomic restrictions found in IMF agreements with the borrowers. The World Bank's "priority actions" suggest that maintenance of output should have the highest priority in dealing with financial crises, since employment and social services for the poor could not be promoted by a country whose per-capita GNP had substantially declined.

2 How to Advise and Assist Countries in Transition from Communism to a Market Economy

Helping former Soviet countries that have never known private ownership of land and productive facilities or private markets for commodities and that lack legal systems for protecting property rights and settling disputes has presented serious problems for both the IMF and the World Bank (IMF, 1999). Institutional and cultural changes come very slowly, but countries need external assistance to maintain output and investment during the transition period. Both Harry White and Treasury Secretary Hans Morgenthau were anxious for the Soviet Union to become a member of the IMF and World Bank. They believed that a communist country could maintain the obligations of members of the IMF by allowing consumers to buy foreign goods freely without payment restrictions and by maintaining a fixed relationship between the domestic currency and foreign currencies for current transactions. White was also hopeful that Soviet countries would eventually become market economies. But Stalin and other communist leaders rejected membership in the IMF and World Bank; former Soviet countries did not join until the Soviet Union was dissolved.

During the 1990s, former Soviet countries experienced financial crises in the form of sharp decreases in the foreign exchange value of their currencies and the inability to make payments on foreign debts. The existence of chaotic governments that lack control over the tax system has made it difficult for the IMF or World Bank to apply the usual loan conditions. However, the United States and other major powers have been anxious for the institutions to provide financial assistance for transition, especially to Russia, because of the fear that a complete breakdown of the economy might lead to military aggression. IMF and World Bank assistance to Russia has been conditioned on balancing the budget by collecting taxes, reducing money creation, and a variety of institutional reforms, including eliminating corruption. However, it has been impossible for the weak and divided government to carry out these conditions. Yet loans are still being made to Russia by both the IMF and World Bank, with the strong support of the leading industrial countries.

3. How to Promote Economic and Social Development in Countries Lacking Basic Institutions for a Market Economy

A number of countries receiving loans from the IMF and the World Bank have made no progress in terms of social or economic development over the past two decades, and their real per-capita income is less than it was 25 years ago. Balance of payments assistance from the IMF is a misnomer for most of these countries, and the president of the World Bank, James D. Wolfensohn, has repeatedly stated that unless the institutional and social structure of poor countries can be changed, external assistance will contribute little to development. The failure of a developing country to change is often due more to political factors than to limited resources. Some poor countries (particularly those in Africa) have experienced civil strife in the form of military coups, and some have been governed by dictators mainly interested in amassing personal wealth outside the country. There is little the World Bank or any other agency can do to promote democracy and peace, and the aid received is unlikely to contribute much to development. The billions of dollars in IMF credits to these countries have accomplished little and have put the borrowers heavily in debt. In recent years the World Bank has included in its conditionality for loans such requirements as legal reforms, tax reform, privatization of state-controlled enterprises, and governmental efforts to eliminate corruption. Reform in these countries is unlikely to occur without basic political chance.

Not much attention was paid to social progress and institutional change at Bretton Woods. In line with most economic thinking at the time, development was regarded as a function of foreign capital inputs, which were believed to promote growth up to a level of income that would provide sufficient domestic savings for self-sustaining growth. Harry White and other members of the U.S. delegation emphasized foreign private capital to promote development, and, indeed, according to its charter a primary function of the World Bank is to stimulate the flow of private capital to developing countries. Developing country representatives at Bretton Woods were not enthusiastic about private capital inflow. They were suspicious of direct investment and could scarcely have imagined U.S. mutual funds investing in the stock markets of developing countries.

Some of the delegates at Bretton Woods advocated a more comprehensive role for the World Bank than simply financing individual projects, a limitation advocated by White. They wanted the World Bank to become a development institution that would finance a broad range of programs for economic and social progress. The World Bank has gradually evolved into such an institution. However, most of the delegates would have opposed the comprehensive loan conditions currently imposed by the World Bank, which include privatization of state enterprises, free commodity and capital markets, and legal reforms. They were fearful of external interference with their economic and social structure by an institution they believed would be dominated by the leading developed countries.

Despite the emphasis on promoting private capital flows in the World Bank, the World Bank did little promoting. The World Bank's Articles provide that it cannot make loans or guarantees on private investments without the guarantee of the government of the receiving country. Such loans were of small interest to private investors since the guaranteeing governments usually imposed controls over such investments. It was not until the establishment of the IFC as an affiliate of the World Bank in 1956 that loans for private investment could be made by the World Bank Group without a government guarantee. However, because of limited funds, the IFC did not make a significant number of loans until the early 1990s (Haralz, 1997, chap. 13). Only recently has the World Bank included liberalizing laws governing foreign direct investment in its loan conditions.

4. What to Do with the SDR Facility?

Both the retention and expansion of the SDR system are being promoted by the IMF management as a means of expanding the volume of international reserves and of providing more aid to developing countries. Under the system established in 1959, SDRs are allocated to all members on the basis of their IMF quotas. The system was expected to provide a means of controlling the total volume of international reserves, since SDRs are regarded as reserve assets. Holders of SDRs can exchange them for the currencies of other members, and all members agree to accept SDRs in exchange for their currencies. In September 1997, the IMF board of governors proposed that an additional 21.4 billion SDRs be allocated to the members, which would more than double the total amount of SDRs held.

The SDR system is of some historical interest because it contains elements of

Keynes's proposal for an international clearing union (ICU) as an alternative to White's proposal for a contributed fund. American and British officials debated the advantages of the two systems during a number of meetings in 1943, but the U.S. delegation rejected the ICU proposal on the grounds that the clearing union principle was unfamiliar to the American public and would be rejected by Congress. In both the ICU and the SDR systems, the financial assets are created rather than being contributed by member countries. As is the case with Keynes's ICU proposal, in which debtor countries could make payments because creditor countries agreed to accept credits in the union, creditor countries agree to accept SDRs in payment for debts or in exchange for their own currencies.

Perhaps the principal benefit of the SDR system has been to provide the IMF with a unit of account other than gold or dollars. The value of the SDR is determined by the market value of a basket of five currenciesthe U.S. dollar, the deutsche mark, the Japanese yen, the French franc, and the British pound sterling-with each currency having a fixed percentage weight in the basket. The market value of the basket changes daily with changes in the exchange rates of the currencies. In 1998 the market value of the SDR was about $1.35.

A serious error made at Bretton Woods was to make the dollar (or its equivalent in terms of a fixed amount of gold) the unit of account for determining par values of the currencies. With the dollar as the standard, the exchange value of the dollar in relation to all other currencies could not be changed except by a uniform percentage change in the dollar value of each of the other currencies. Keynes proposed an international unit of account, which he called "unitas," that had a fixed value in terms of gold, but the value of the dollar in terms of unitas could be changed. White opposed Keynes's proposal because any change in the official gold value of the dollar would have required congressional action. Also, White could not imagine that there would ever be a need to devalue the dollar. However, during the late 1960s the United States had a substantial balance of payments deficit, which led to the foreign accumulation of dollars and a substantial amount of conversion into gold. In 1971 President Nixon took the United States off the gold standard by declaring the dollar no longer convertible into gold. Because the currencies of other IMF members were not convertible into gold but only into dollars, their par values in terms of gold were no longer equal to a fixed amount of dollars, and the dollar value of their currencies fluctuated freely in the exchange markets. Had there been an international unit of account independent of any currency, the value of the dollar could have been depreciated in terms of the standard after the dollar was no longer convertible into gold. This would have enabled the United States to devalue its currency to restore balance of payments equilibrium without destroying the par value system. The SDR provides such a standard. If there should be international agreement on exchange rate stability, the value of each currency would probably be defined in terms of SDRs.

5. Existence of Two Institutions Making the Same Kinds of Loans to the Same Countries

For more than two decades both the IMF and World Bank have made financial assistance available only to developing countries. The Bretton Woods agreement provided that the IMF would make available "balance of payments assistance," whereas the World Bank would make loans mainly to finance specific projects. In recent years a substantial portion of World Bank loans have taken the form of general-purpose loans to finance broad economic and social programs; the IMF has been making generalpurpose loans (called structural adjustment loans) for similar objectives. These conditions result in duplication of functions, along with the possibility that the conditions established by the two institutions might be inconsistent. Although some coordination exists, loan conditions for the same borrowers have not been uniform. The IMF argues that its assistance differs from that of the World Bank because it aids countries in achieving balance of payments equilibrium, while World Bank assistance contributes to economic development. But often these are simply different names for the same function.

The conditions relating to economic and social problems imposed by both the World Bank and the IMF would not have been anticipated by the Bretton Woods participants. The conditions for drawing on the IMF was a major subject of debate between White and Keynes at the preconference meetings in Bretton Woods and at the Savannah conference in 1946 when the two institutions were initiated. Keynes wanted a substantial portion of the drawing rights from the IMF to be available automatically so that they could be treated as reserves, but White insisted that all drawings be subject to conditions established by the IMR White argued that the IMF had to be satisfied that the member was taking steps to correct the disequilibrium in its balance of payments before receiving credits. However, White would not have imagined that the IMF would be providing credits for economic and social programs having little to do with disequilibrium. The World Bank was expected to apply conditions to its loans relating to the specific projects being financed, but it was not anticipated that the World Bank would make large general-purpose loans subject to a variety of economic and social policies unrelated to projects.

Critics of the duplication by the two institutions have proposed a variety of solutions. George Shultz (1995), former secretary of State and University of Chicago Economics professor, advocates merging the two institutions by putting both under control of the president of the World Bank. Others favor abolishing the IMF rather than continuing to increase its resources. This is the position of Anna J. Schwartz and Walker F Todd (1998). The Bretton Woods Commission (1994) favors close cooperation between the World Bank and IMF in the case of loans to the same country. In discussing close collaboration between the IMF and World Bank in making loans to the same country, Polak (1994) points out that this could amount to cross-conditionality in which no country could obtain credits from either the IMF or the World Bank without the approval and conditions of the other institution. He states that developing countries would consider such an arrangement as ganging up by the two institutions and would oppose cross-conditionality. The problem would never have been anticipated by the Bretton Woods participants, who viewed the World Bank and IMF as having distinct functions. Nor would they have expected the institutions to be making loans with conditions covering as wide a range of economic and social policies as is the case today.

The U.S. government, which has defended the IMF against critics at home and abroad, has recently proposed the IMF limit its mission to making emergency loans to countries that face short-term currency crises and phase out long-term lending for development, which should be a function of the World Bank. In a recent statement, Secretary of the Treasury Summers strongly defended the IMF as indispensable, stating that it should be limited in its financial involvement to assisting countries experiencing financial crises (Kahn, 1999).

Most supporters of the IMF argue that it has a unique role to play in assisting countries in times of financial crisis and in reforming foreign exchange practices that inhibit trade. Some also see a role for the IMF in the reestablishment of a par value system or some form of collective management of international exchange rates. However, the governments of the leading developed countries show little support of this role.

III. HOW SHOULD THESE PROBLEMS BE DEALT WITH?

The following paragraphs outline the author's solutions to the problems identified above.

1. Most of the advice found in the literature for dealing with the recent financial crises has been directed toward preventing future crises rather than to what the IMF or World Bank should do after a crisis has occurred. The most important actions that should be taken to reduce vulnerability to crises are reform of the banking and credit systems and discouraging short-term or speculative capital imports that do not contribute to productive investment. One way of discouraging short-term capital imports is through a Tobin tax on all foreign exchange transactions (ul Haq et al., 1996). The Tobin tax is designed to make short-term capital imports unprofitable because the return would need to be very high to compensate for the tax on both buying and selling the domestic currency. I would, however, recommend exempting from the tax all foreign exchange transactions relating to foreign direct investment so as not to discourage such investment.

A similar exemption might be made for longterm loans, provided the proceeds were used for productive purposes.

Once a financial crisis occurs, more drastic measures are needed to limit the economic and social costs. The exchange rate should be prevented from plummeting as a consequence of capital flight and currency speculation. If inflationary pressures do not exist, measures should be taken to prevent a decline in domestic spending and the availability of credit for production and trade. To insulate the exchange rate from capital movements and currency speculation, an official market for foreign exchange used for current transactions should be established. (Current transactions are defined here as exports and imports of merchandise and services, including interest on debts.) Capital transactions not permitted to take place in the official market should take place in a free capital market. There should be no controls on imports, but all export receipts would be required to be sold in the official exchange market. Failure to surrender export receipts to the official market would be regarded as an illegal capital export. The exchange rate in the official market should fluctuate freely in response to demand and supply from current transactions, except when the rate is supported by the central bank-which might use IMF credits for this purpose. The exchange rate in the free capital market should not be subject to any control. When the financial crisis is over, the exchange rates in the two markets should be approximately equal and all exchange restrictions removed.

Credits from the IMF or other official external sources should be made available only for financing deficits in the current account. Instead of IMF credits being conditioned on monetary restrictions, monetary and credit expansion should be encouraged as long as inflation is moderate; economic policy should be directed to maintaining consumer and investment demand. External debts should be renegotiated, and principal payments should not be made during the crisis. Such an arrangement would be in accordance with the original intentions of the Bretton Woods participants and Article VI of the IMF's Articles of Agreement, which prohibits the use of IMF funds for financing capital exports.

I am in general agreement with the arguments against exchange controls. However, in a period of financial crisis, it is essential to limit the impact of financial shock on production, investment, and essential government services. This objective cannot be achieved when a country experiences a 50% or more depreciation in its currency, a threefold rise in interest rates, and unavailability of credit for production and trade. To maintain domestic production once a financial crisis has occurred, the foreign exchange market for financing current transactions must be insulated from the capital market. In addition, the foreign exchange rates in both markets should be determined by demand and supply, rather than by government edict. Macroeconomic policies should be targeted to reducing the current account deficit while maintaining output.

2. Assistance to countries in transition from communism to market economies should be provided only in response to carefully planned economic reforms and the creation of market institutions. If needed for defense purposes, financial assistance should be charged to the budgets of the defense and state departments! The IMF's balance of payments assistance has no relevance for Russia or for certain other former Soviet countries. Transition assistance is mainly a job for the World Bank and, as much as possible, the World Bank should make loans only for specific programs and projects rather than for general budgetary purposes.

3. A major failure of postwar international economic policy is the lack of progress in many developing countries for raising or even maintaining per-capita output for billions of very poor people. This is often more of a political than an economic problem, and the IMF and World Bank can make only a minor contribution to reducing civil strife and corruption. Most of the so-called balance of payments and general budgetary support loans to these countries have been a waste of international public resources. Assistance should be based on specific programs and projects within a framework of planned structural reform with substantial oversight by the lending institutions. The highest priority should be given to loans for educational and health programs and, to the extent that external aid can make a difference, to restructuring the tax and budgetary administrative systems.

4. My recommendation for the SDR program is very simple: Just abolish it. There is no shortage of international reserves, and SDRs are a poor form of foreign assistance. Abolishing SDRs would involve a considerable amount of debt forgiveness for those developing countries that have used their SDRs to acquire foreign currencies, and there would be a reduction in reserve assets for countries holding SDRs. Countries that have acquired SDRs from other countries in exchange for their currencies or in payment of debts might be compensated by an equivalent increase in their reserve positions in the IMF

5. The existence of two international institutions making the same kinds of loans to the same countries is inefficient and wasteful of public funds. I favor a merger of the IMF and World Bank under the leadership of the World Bank. This would preserve the assets of the IMF for assisting developing countries. A full merger of the assets and liabilities of the institutions would create very complex problems requiring legislative action by the IMF and the World Bank member countries. A simple way to merge the institutions would be to make the president of the World Bank also the managing director of the IMF and for each executive director to serve as the executive director for both institutions. This might be achieved without a renegotiation of the Articles of Agreement of the two institutions. Determining which institution would provide credits to individual countries would create some problems, but they could be worked out by a joint staff under a single management. Such an arrangement would clearly violate the intentions of the Bretton Woods founders, but they would never have expected that the functions and operations of the two institutions would be as comparable as they are today.

Since this article was written, the report of the International Financial Institution Advisory Commission (Meltzer Commission), a commission established by the U.S. Congress, was issued (March 8, 2000). This report recommends that the IMF's lending operations be largely limited to short-term liquidity loans to countries experiencing a financial crisis, subject to preconditions, such as freedom of entry of foreign financial institutions and proper fiscal requirements. The IMF would no longer provide long-term loans for development assistance or for structural transformation of transitional economies. Lending for these purposes would be the function of the World Bank and the regional development banks. However, the loan operations of these banks would be largely limited to countries without access to private capital markets, and with per-capita incomes under $4,000 per year. The IMF liquidity loans would have a maturity not to exceed four months with only one allowed rollover; this period is regarded as sufficient time for dealing with a financial crisis.

The commission's recommendations would eliminate the duplication of IMF operations with those of the development banks, but I believe they are much too restrictive on the functions of the IMF Short-term liquidity assistance could only provide temporary support of a currency or maintain foreign debt service, without there being time for fundamental balance of payments adjustment. According to the Bretton Woods Agreements, the IMF was designed to assist a member country in financing its current account deficit while implementing policies to restore balance of payments equilibrium. Monetary and fiscal restrictions and exchange rate adjustments usually require several years to correct a current account deficit. Also, there is a close relationship between policies that affect the balance of payments and those that promote economic development. Therefore, I believe that both functions should be carried on by a single institution represented by a merger of the IMF and the World Bank.

[Reference]

REFERENCES

[Reference]

Bretton Woods Commission, Bretton Woods: Looking to the Future, Bretton Woods Committee, Washington, DC, 1994.
Haralz, Jonas, "The International Finance Corporation," in The World Bank, vol. 2, Brookings Institution, Washington, DC, 1997.
International Monetary Fund, The International Monetary Fund, 1945-1965, International Monetary Fund, Washington, DC, vols. 1, 2, and 3, 1969.
"Transition: Achievements and Challenges," Finance and Development 36:2, June 1999, 2-27. Kahn, Joseph, "Treasury Secretary Offers a New Vision
for the IMF," New York Times, December 15, 1999, C4.
Kaminsky, Graciela L., and Carmen M. Reinhart, "The Twin Crises: The Causes of Banking and Balance of Payments Problems," American Economic Review, 89:3, June 1999, 473-500.

[Reference]

Kregel, J. A., East Asia Is Not Mexico: The Dif ference between Balance of Payments Crises and Debt Deflations, Working Paper No. 235, Jerome Levy Economics Institute, Bard College, New York, May 1998.
Lustig, Nora, "The First to Suffer, the Last to Recover," IADBAMERICA, Inter-American Development Bank, Washington, DC, March/April 1999, 1-3.

[Reference]

Mikesell, Raymond F, The Bretton Woods Debates: A Memoir, Essays in International Finance, No. 192, International Finance Section, Princeton University, Princeton, NJ, March 1994.
Moreno, Ramon, "Depreciation and Recessions in East Asia," Economic Review, 3, 1999, 27-39.
Polak, J. J., "The World Bank and the IMF: The Future of Their Coexistence," in Bretton Woods: Looking to the Future, Bretton Woods Commission, Washington, DC, 1994.
Sachs, Jeffrey D., "The Wrong Medicine for Asia," New York Times, November 3, 1997, A19.
Schwartz, Anna J., and Walker F Todd, Time to Abolish the International Monetary Fund and the Treasury's Exchange Stabilization Fund, Committee for Monetary Research and Education, Charlotte, NC, December 1998.
Shultz, George P, "Economics in Action: Ideas, Institutions and Policies," American Economic Review, 85:3, May 1995.
Uchitelle, Louis, "World Bank Economist Felt He Had to Silence His Criticism or Quit," New York Times, December 2, 1999, Cl.
ul Haq, Mahbub, Inge Kaul, and Isabelle Grunberg, eds., The Tobin Tax: Coping with Financial Volatility, Oxford University Press, Oxford, 1996.
World Bank, Global Economic Prospects and the Developing Countries, World Bank, Washington, DC, 1998-99.
ADDITIONAL READINGS

[Reference]

Black, Stanley W, A Levite among the Priests: Edward M. Bernstein and the Origins of the Bretton Woods System, Westview Press, Boulder, CO, 1991.
International Monetary Fund, Financial Organizations and Operations of the IMF, Pamphlet Series, No. 4, 2nd ed., International Monetary Fund, Washington, DC, 1991.
International Monetary Fund Annual Report 1999, International Monetary Fund, Washington, DC. 1999.

[Reference]

Krugman, Paul, "Saving Asia: It's Time to Get Radical," Fortune Magazine, September 7, 1998, 74--80.

Mikesell, Raymond F, "Negotiating at Bretton Woods, 1944," in Negotiating with the Russians, Raymond Bennett and Joseph E. Johnson, eds., World Peace Foundation, Boston, MA, 1951, 101-116.
Foreign Exchange in the Post-War World, Twentieth Century Fund, New York, NY, 1954. Oliver, Robert W, International Economic Cooperation
and the World Bank, Macmillan, London, 1975. Tobin, James, "Liquidity Preference as Behavior towards Risk," Review of Economic Studies, 15, February 1958, 65-86.
United States Government Printing Office, United Nations Monetary and Financial Conference, Final Act and Related Documents (Bretton Woods, New Hampshire, July 1-22, 1944), Washington, DC, 1944.

[Author note]

RAYMOND F MIKESELL*

[Author note]

*This is a revised version of a paper presented at the Western Economic Association International 74th annual conference, San Diego, July 10-12, 1999.
Mikesell: Emeritus Professor, Department of Economics, University of Oregon, Eugene, OR, Fax 1-541-3461243, E-mail mikesell@oregon.uoregon.edu